

All eyes are on the issue of US-China trade and the US' tariffs on motor cars

YUUSUKE YOKOTA
KEI SHIMOZATO
ECONOMIC RESEARCH OFFICE

MUFG Bank, Ltd.
A member of MUFG, a global financial group

9 AUGUST 2018
(ORIGINAL JAPANESE VERSION RELEASED ON 27 JULY 2018)

1. The Real Economy

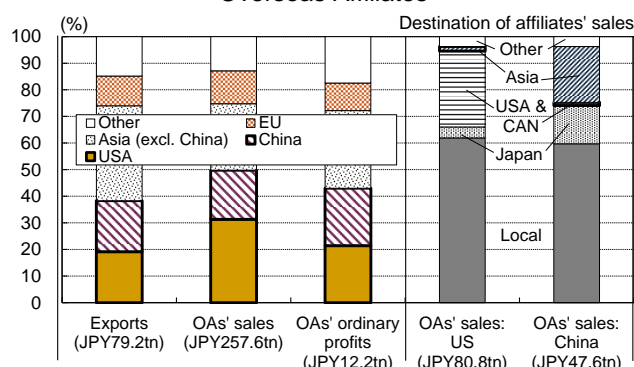
The conflict between the US and China regarding trade policies is growing in intensity. In response to the US announcing on 6th July that it will impose tariffs against USD 34 billions' worth of Chinese goods, China decided to retaliate immediately with its own tariffs, matching the US' in terms of scale. This has resulted in a cycle of tit for tat with the US drawing up a list of additional goods for tariffs worth USD 200 billion.

It goes without saying that such action could have an impact on the business activities of Japanese corporations, which have a strong economic relationship with both the US and China. Looking at Japanese exports in FY2017, the ratio of exports to the US and China was 19% each, together constituting nearly 40% (Chart 1). Moreover, looking at Japanese companies overseas affiliates' operations in FY2016, the sales of affiliates in the US and China combined was approximately 50% of the total, and the ratio of ordinary profits for the US and China together was also high at 43%. The breakdown of US and Chinese overseas affiliates' sales by region shows that the ratio of sales to Asia from overseas affiliates in the US was 1.7%, and sales to the US and Canada by overseas affiliates in China was 1.2%: both low. It appears that the direct impact of tariffs on shipments by Japanese companies' overseas affiliates' would be limited. However, assuming that local companies are exporting finished products to the US and China, exports and affiliates' sales will be affected as a rise in prices due to the exchange of retaliatory tariffs will put downward pressure on the economies of both countries.

It is necessary to keep an eye on the direction taken by the US regarding the additional tariffs on motor vehicles and parts it is considering in terms of the Japanese economy. The automotive industry has a large induced effect on other industries' production though a pyramid-shaped supply chain with completed car manufacturers at the top. Based on 2014's input-output table, the value of domestic induced production per JPY 1 million of final demand for passenger motor cars reached JPY 2.76 million, and had an impact on a wide range of industries, such as motor vehicles parts and iron and steel (Chart 2). Under present conditions, where just less than 20% of domestically-produced motor cars are exported to the US, if the high value of US tariffs causes a decrease in demand, it is possible this will lead to a downturn of the gradually-expanding Japanese economy. It will be important to keep an eye on the

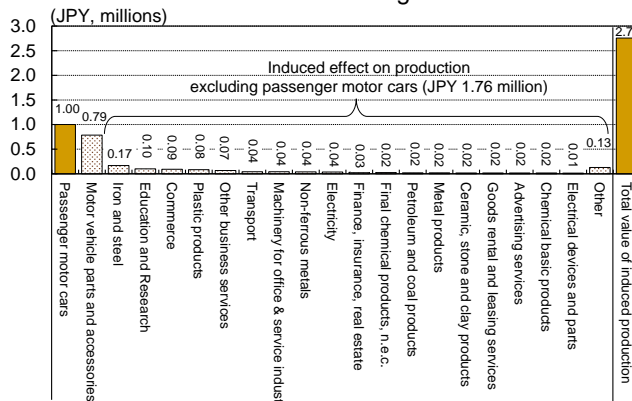
direction of the US-Japan trade dialogue, which is scheduled to start in August, as well as the conflict over trade between the US and China.

Chart 1: Japanese Exports and Japanese Companies' Overseas Affiliates



Note: Exports data from FY 2017, overseas affiliates from FY 2016
 OA=Overseas affiliates
 Source: Ministry of Economy, Trade and Industry, MUFG Bank Economic Research Office

Chart 2: Value of Induced Production Per JPY 1 Million of Final Demand for Passenger Motor Cars



Source: Ministry of Internal Affairs and Communications, MUFG Bank Economic Research Office

2. Prices and Financial Markets

At present, prices lack momentum. In June, core CPI (Consumer Price Index less fresh food) rose by 0.8% YoY, increasing from 0.7% YoY the previous month; however, the main contribution to this rise was from energy prices. On a core core basis (CPI less fresh food and energy), which shows the underlying trend of prices, growth was gradual at 0.2% YoY.

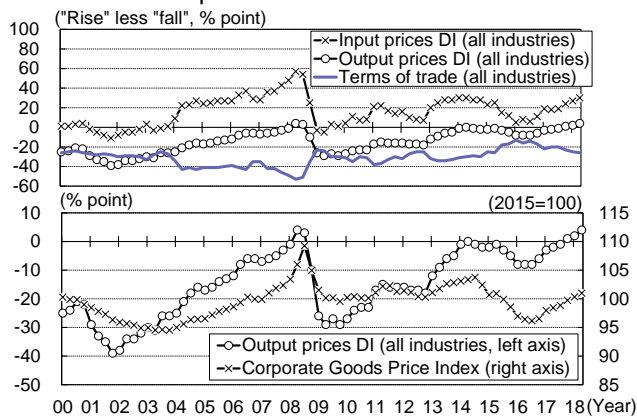
The input and output prices surrounding corporations can be ascertained with the Bank of Japan's Tankan survey; the "input prices DI (diffusion index)" has reached the same level as a recent peak in 2014 as a rise in labour costs brought about by the labour shortage and a rise in oil prices appear to be putting pressure on corporations' expenses (Chart 3). On the other hand, the "output prices DI" has also been rising for around the last two years and is at an historically high level, yet its pace of increase is slow compared with the "input prices DI", and it can be assumed that there has been little progress in transferring these prices onto corporations' goods and services. In other words, the terms of trade have been worsening since 2016, and it appears that corporations have not been able to raise output prices in keeping with the rise in costs.

By comparing the "output prices DI" and the "employment conditions DI" since Abenomics, it is possible to see the relationship between output prices and the labour shortage. In sectors where the labour shortage is worsening, such as "accommodation, eating and drinking services" and "transport and postal activities", prices are being set higher, yet it appears that the trend across sectors as a whole remains fairly gradual (Chart 4). The relationship between the strength of the "output prices DI" and the price of corporate goods is changing, suggesting a change in the competitive environment. Looking ahead, corporations are expected to take steps to shift labour costs onto prices little by little as the labour shortage grows and the gap between supply and demand tightens due to the gradual growth of the economy. However, it is

unlikely that this rise in prices will act as a significant tailwind and growth of consumer prices is forecast to remain at around 1% YoY.

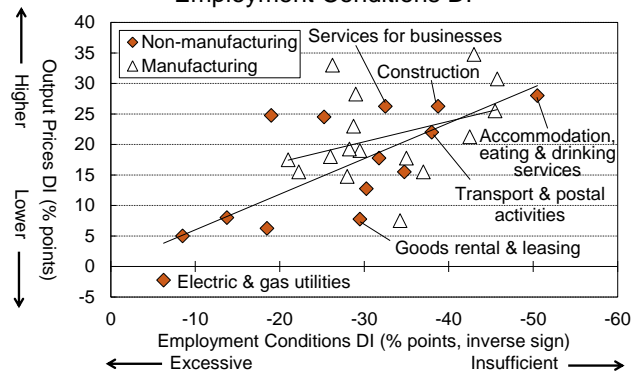
On 18th July, the USD strengthened to just above JPY 113 for the first time in around half a year owing to optimistic views expressed at Fed Chairman Powell’s testimony to Congress about a continued rise of US interest rates. Subsequently, the USD weakened due to speculation that the BoJ will adjust its monetary policy, and is currently around JPY 111 per USD. Even if the BoJ does make an adjustment in the future, it will only be slight; it appears that the easy monetary conditions will remain. Despite periods of temporary JPY appreciation owing to speculation about monetary policy and risk aversion regarding US trade policy, the JPY is forecast to continue to gradually depreciate, reflecting the fundamental difference in directions between Japanese and US monetary policy.

Chart 3: Enterprises' Prices DI and Terms of Trade, Corporate Goods Price Index



Note: "Terms of trade" = "output prices DI" less "input prices DI"
 Source: Bank of Japan, MUFG Bank Economic Research Office

Chart 4: Correlation between Output Prices DI and Employment Conditions DI



Note: For each indicator, the change from the average value for 2012 until the Apr-Jun quarter 2018 for every industry across all enterprises was plotted.
 DI = diffusion index
 Source: Bank of Japan, MUFG Bank Economic Research Office

(Translated by Elizabeth Foster)

MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

1. Main Economic Indicators

As of Jul. 27, 2018

	Fiscal	Fiscal	2017		2018	2018				
	2016	2017	3Q	4Q	1Q	FEB	MAR	APR	MAY	JUN
Real GDP Growth Rate <% changes from previous period at SA annual rate>	1.2	1.6	2.0 (2.0)	1.0 (1.9)	-0.6 (1.1)	***	***	***	***	***
Index of All Industries Activity	0.5	1.7	-0.1 (1.5)	0.7 (1.8)	-0.5 (1.3)	0.4 (1.1)	-0.1 (1.1)	1.0 (1.4)	0.1 (1.6)	
Industrial Production Index	1.0	4.1	0.5 (4.0)	1.6 (4.6)	-1.3 (2.4)	2.0 (1.6)	1.4 (2.4)	0.5 (2.6)	-0.2 (4.2)	
Production										
Shipments	0.8	3.3	0.6 (3.8)	0.8 (3.1)	-1.1 (1.5)	1.6 (0.7)	1.2 (1.4)	1.6 (3.6)	-1.6 (3.3)	
Inventory	-4.0	3.9	-1.4 (-2.5)	2.2 (1.9)	3.4 (3.9)	0.5 (1.6)	3.3 (3.9)	-0.6 (1.7)	0.6 (2.5)	
Inventory/Shipments Ratio (2010=100)	112.9	112.4	111.1 [114.3]	112.1 [109.7]	114.9 [111.1]	114.0 [111.1]	117.1 [111.0]	113.8 [113.1]	113.9 [111.7]	110.7
Domestic Corporate Goods Price Index	-2.4	2.7	0.4 (2.8)	0.9 (3.3)	0.6 (2.5)	0.1 (2.6)	-0.1 (2.1)	0.2 (2.1)	0.6 (2.7)	0.2 (2.8)
Consumer Price Index(SA, total, excl.fresh foods)	-0.2	0.7	0.0 (0.6)	0.5 (0.9)	-0.2 (0.8)	0.1 (1.0)	-0.1 (0.9)	-0.1 (0.7)	0.0 (0.7)	0.1 (0.8)
Index of Capacity Utilization (2010=100)	98.6	101.7	101.6 [98.0]	102.7 [100.1]	101.0 [100.1]	101.9 [100.8]	102.4 [100.2]	104.2 [103.5]	102.0 [100.3]	101.7
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	0.5	-0.8	2.8 (-2.5)	0.3 (0.0)	3.3 (0.2)	2.1 (2.4)	-3.9 (-2.4)	10.1 (9.6)	-3.7 (16.5)	
Manufacturing	-4.6	9.2	6.2 (9.2)	3.5 (13.3)	2.5 (10.6)	8.0 (21.4)	-17.5 (1.5)	22.7 (23.5)	1.3 (26.2)	
Non-manufacturing Excl.Electric Power & Ship building	4.3	-7.8	0.0 (-10.1)	-2.1 (-9.7)	3.4 (-6.9)	0.0 (-10.4)	2.2 (-4.9)	0.4 (-1.1)	0.2 (8.4)	
Shipments of Capital Goods (Excl.Transport Equipment)	1.4	6.2	1.2 (4.3)	3.1 (7.2)	-0.5 (7.0)	-1.4 (3.1)	3.0 (8.3)	2.5 (9.5)	-4.6 (3.8)	
Construction Orders	4.0	0.7								
Private	5.1	0.6								
Public	8.4	-5.4								
Public Works Contracts	4.1	-4.3								
Housing Starts 10,000 units at Annual Rate, SA	97.4 (5.8)	94.6 (-2.8)	95.5 (-2.4)	94.8 (-2.4)	89.2 (-8.0)	92.6 (-2.6)	89.5 (-8.3)	99.2 (0.3)	99.6 (1.3)	
Total floor	(4.1)	(-3.7)	(-3.7)	(-3.2)	(-9.2)	(-5.6)	(-7.2)	(-2.1)	(0.1)	
Sales at Retailers	-0.2	1.9								
Real Consumption Expenditures of Households over 2 persons (SA)	-1.6	0.4	-0.4 (0.0)	-0.6 (0.5)	1.1 (0.6)	-1.5 (0.1)	-0.1 (-0.2)	-1.6 (-1.3)	-0.2 (-1.4)	
Propensity to Consume (SA, %)	72.1	71.7	70.3 [71.3]	71.3 [71.8]	71.4 [73.0]	69.3 [75.1]	70.6 [72.4]	70.2 [73.1]	72.3 [77.0]	73.8
Overtime Hours Worked (All Industries, 5 employees or more)	-0.7	0.4	-0.2 (0.9)	0.3 (1.2)	-1.1 (-1.2)	1.4 (-0.9)	-0.1 (-0.9)	0.4 (0.0)	1.3 (0.9)	
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	0.4	0.7								
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	103	105	130	133	25	30	21	13	7	
Ratio of Job Offers to Applicants (SA, Times)	1.39	1.54	1.52 [1.37]	1.57 [1.41]	1.59 [1.44]	1.58 [1.44]	1.59 [1.45]	1.59 [1.47]	1.60 [1.49]	1.50
Unemployment Rate (SA, %)	3.0	2.7	2.8	2.7	2.5	2.5	2.5	2.5	2.2	
Economy Watcher Survey (Judgment of the present condition D.I.%)	46.4	50.5	50.3 [45.5]	53.3 [49.8]	49.1 [48.7]	48.6 [48.8]	48.9 [47.9]	49.0 [48.5]	47.1 [49.1]	48.1 [50.0]
Bankruptcies (Number of cases)	8,381 (-3.5)	8,367 (-0.2)	2,032 (-2.6)	2,106 (1.0)	2,041 (-1.8)	617 (-10.3)	789 (0.4)	650 (-4.4)	767 (-4.4)	690 (-2.3)

(Notes)

Unless otherwise indicated, tabulated figures and those in parentheses show % changes from previous quarter/month as applicable.

The figures in () indicate % changes from previous year.

[] show the comparable figure of the previous year.

2. Balance of Payments

As of Jul. 27, 2018

	Fiscal	Fiscal	2017		2018	2018				
	2016	2017	3Q	4Q	1Q	FEB	MAR	APR	MAY	JUN
Customs Clearance (Exports in Yen Terms)	-3.5	10.8	(15.1)	(13.0)	(4.9)	(1.8)	(2.1)	(7.8)	(8.1)	(6.7)
Value	-5.8	6.0	(8.8)	(8.1)	(2.4)	(4.1)	(0.3)	(3.0)	(3.7)	(5.2)
Volumes	2.4	4.5	(5.8)	(4.6)	(2.6)	(-2.1)	(1.8)	(4.6)	(4.2)	(1.5)
Imports (In Yen terms)	-10.2	13.7	(14.8)	(17.0)	(7.4)	(16.6)	(-0.5)	(6.0)	(14.0)	(2.5)
Value	-10.7	10.1	(12.8)	(12.7)	(4.7)	(4.4)	(4.5)	(4.5)	(7.2)	(9.0)
Volumes	0.5	3.3	(1.8)	(3.9)	(2.6)	(11.7)	(-4.8)	(1.5)	(6.4)	(-5.9)
Current Account (100 mil. yen)	210,188	218,127	70,061	43,257	58,821	21,082	31,816	18,451	19,383	
Goods (100 mil. yen)	57,851	45,936	17,588	11,527	7,246	1,977	11,876	5,738	-3,038	
Services (100 mil. yen)	-13,813	-5,378	-2,652	-1,975	2,127	1,476	2,282	-5,015	423	
Financial Account (100 mil. yen)	247,407	196,174	45,817	30,753	75,622	17,063	46,057	4,254	33,208	
Gold & Foreign Exchange Reserves (\$1mil.)	1,230,330	1,268,287	1,266,310	1,264,283	1,268,287	1,261,749	1,268,287	1,256,018	1,254,477	1,258,748
Exchange Rate (¥/\$)	108.37	110.80	111.01	112.95	108.20	107.82	106.00	107.43	109.69	110.03

3. Financial Market Indicators

	Fiscal	Fiscal	2017		2018	2018					
	2016	2017	3Q	4Q	1Q	FEB	MAR	APR	MAY	JUN	
Uncollateralized Overnight Call Rates	-0.045	-0.050	-0.054	-0.042	-0.048	-0.042	-0.062	-0.063	-0.061	-0.071	
			[-0.046]	[-0.043]	[-0.042]	[-0.038]	[-0.042]	[-0.054]	[-0.053]	-0.056	
Euro Yen TIBOR (3 Months)	0.057	0.065	0.062	0.063	0.078	0.068	0.097	0.097	0.078	0.078	
			[0.057]	[0.056]	[0.056]	[0.056]	[0.056]	[0.056]	[0.056]	[0.056]	
Newly Issued Japanese Government Bonds Yields (10 Years)	0.065	0.045	0.060	0.045	0.045	0.045	0.045	0.050	0.030	0.030	
			[-0.085]	[0.040]	[0.065]	[0.050]	[0.065]	[0.015]	0.040	[0.075]	
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	0.847	0.817	0.831	0.828	0.817	0.827	0.817	0.793	0.794		
			(-0.011)	(-0.003)	(-0.011)	(0.000)	(-0.010)	(-0.024)	(0.001)		
The Nikkei Stock Average (TSE 225 Issues)	18,909	21,454	20,356	22,765	21,454	22,068	21,454	22,468	22,202	22,305	
			[16,450]	[19,114]	[18,909]	[19,119]	[18,909]	[19,197]	[19,651]	[20,033]	
M2(Average)	(3.6)	(3.7)	(4.0)	(3.9)	(3.2)	(3.2)	(3.1)	(3.2)	(3.2)	(3.2)	
Broadly-defined Liquidity(Average)	(1.8)	(3.2)	(3.5)	(3.7)	(3.0)	(2.9)	(2.9)	(3.2)	(3.2)	(3.1)	
Principal Figures of Financial Institutions											
Loans and Discount (Average)	Banks & Shinkin	(2.4)	(2.8)	(3.1)	(2.6)	(2.1)	(2.1)	(2.0)	(2.1)	(2.0)	(2.2)
	Banks	(2.4)	(2.8)	(3.2)	(2.6)	(2.1)	(2.1)	(1.9)	(2.0)	(1.9)	(2.1)
	City Banks etc.	(1.2)	(2.0)	(2.8)	(1.7)	(0.7)	(0.6)	(0.3)	(0.5)	(0.3)	(0.6)
	Regional Banks	(3.5)	(3.7)	(3.7)	(3.7)	(3.5)	(3.6)	(3.5)	(3.6)	(4.4)	(4.5)
	Regional Banks II	(3.1)	(3.0)	(3.1)	(3.0)	(2.8)	(2.8)	(2.8)	(2.7)	(-0.5)	(-0.4)
	Shinkin	(2.3)	(2.7)	(2.7)	(2.6)	(2.5)	(2.5)	(2.5)	(2.3)	(2.3)	(2.3)
Deposits and CDs (Average)	Total(3 Business Condition)	(3.8)	(4.2)	(4.5)	(4.3)	(3.5)	(3.5)	(3.3)	(3.8)	(3.8)	(3.8)
	City Banks	(5.5)	(5.9)	(6.4)	(6.1)	(4.9)	(4.9)	(4.5)	(5.3)	(5.1)	(5.3)
	Regional Banks	(2.3)	(2.5)	(2.6)	(2.5)	(2.2)	(2.2)	(2.0)	(2.3)	(3.2)	(3.0)
	Regional Banks II	(2.1)	(2.1)	(2.3)	(2.0)	(1.6)	(1.7)	(1.5)	(1.7)	(-1.1)	(-1.1)

(Notes)

Newly Issued Japanese Government Bonds Yields and Interest rates are averages. The Nikkei Stock Average is as of month-end. Unless otherwise indicated, tabulated figures and those in parentheses show % changes from previous quarter/month as applicable. The figures in () indicate % changes from previous year. [] show the comparable figure of the previous year.

(Sources)

Cabinet Office, National Accounts, Machinery Orders; METI, Indices of Tertiary Industry Activity, Industrial Production, Current Survey of Commerce; MOF, Trade Statistics, Balance of Payments; MPMHAPT, Consumer Price Index, Family Income and Expenditure Survey, Labour Force Survey; MHLW, Monthly Labour Survey; Ministry of Land, Infrastructure, and Transport, Economic Construction Statistics; BOJ, Corporate Price Index, Financial and Economic Statistics Monthly, etc.

For further details, please contact the Economic Research Office, MUFG Bank

Managing Director, Yasuhiro Ishimaru Tel: +81-(0)3-3240-3204

Written by Yuusuke Yokota <yuusuke_yokota@mufg.jp >

Kei Shimozato <kei_shimozato@mufg.jp >

This report is intended for information purposes only and shall not be construed as solicitation to take any action such as purchasing/selling/investing financial market products. In taking any action, each reader is requested to act on the basis of his or her own judgment. This report is based on information believed to be reliable, but we do not guarantee its accuracy. The contents of the report may be revised without advance notice. Also, this report is a literary work protected by the copyright act. No part of this report may be reproduced in any form without express statement of its source. This report is also available for viewing online.

